Cross-Sector Collaborations and Enterprise Risk Management – Strategies for Nonprofit Organizations to Effectively Partner with For-Profit Organizations

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ABSTRACT

Cross-sector collaborations between nonprofit (NP) and for-profit (FP) organizations are growing in popularity in the United States. The synergies of such collaborations allow NPs to more effectively use their capabilities to serve the needs of stakeholders, including donors and volunteers. Despite the popularity of cross-sector collaborations, nonprofit management must maintain, and further reinforce its internal control policies when seeking collaborative partnerships. Reliable internal control policies, along with coherent enterprise risk management (ERM), will enable nonprofit organizations to sustain efficient operations. The balance between growing operations through cross-sector collaborations, while maintaining sound ERM policies, is crucial for today's nonprofit organization. We discuss the inter-relationship between internal control, ERM, and corporate governance within the nonprofit sector.

OVERVIEW

The nonprofit sector in the United States (U.S.) has witnessed a significant growth in collaborations between nonprofit (NP) and for-profit (FP) organizations. The current volatile economic environment has led to decreased funding opportunities for numerous NPs. This competition for limited funds available from government and private sources has led to an increasing number of cross-sector collaborative efforts (Abdy & Barclay, 2001). Cross-sector collaborations use the knowledge and capabilities of NP and FP organizations more effectively through the creation of new opportunities that achieve greater corporate profitability, and assist NPs in their ability to better meet the needs of their target audience (Rondinelli & London, 2003). Motivations for cross-sector collaborations include (but are not limited to) international diversification, technological transfer, market power/market share, competition, efficiency, new or continued services, reduced financial risk, and increased cost savings (Shaw, 2003; Finnerty, Owers, & Rogers, 1986; Kogut, 1988; Tuckman, 1998).

Despite the popularity of cross-sector collaborations, nonprofit management must maintain, and further reinforce its internal control policies when seeking collaborative partnerships. Reliable internal control policies, along with coherent enterprise risk management (ERM), will enable nonprofit organizations to sustain efficient operations. ERM policies provide assurance to management and key stakeholders that organizational objectives can be achieved while managing key risk factors. The balance between growing operations through cross-sector collaborations, while maintaining sound ERM policies, is crucial for today's nonprofit organization.

Many organizations struggle to balance the adequacy and sustainability of the risks relative to their risk appetite and abilities as they pursue strategic goals. While most organizations have a system of internal controls dealing with operations, reporting and compliance, enterprise risk management expands on the internal control procedures and tries to provide assurance to management and stakeholders that the key risk factors can be managed well as the organizational objectives are achieved. Internal control focuses on the day-to-day-process level and is a subset of ERM, which is a subset of corporate governance. The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Enterprise Risk Management — Integrated Framework* (2004) defines ERM as follows:

> Enterprise risk management is a process, effected by the entity's board of directors, management, and other personnel, applied in strategy-setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within the risk appetite, to provide reasonable assurance regarding the achievement of objectives (COSO, 2004).

Even though the COSO wrote the ERM framework for for-profit entities, nonprofit organizations can use the same principles of ERM effectively to improve operations. A COSO report published in 1992 titled *Internal Control — Integrated Framework* - established a framework for internal control and provided tools to entities for evaluating their control systems (COSO, 1992). The framework identifies five inter-related components necessary for effective internal control. It defines the framework as follows:

> Internal control is a process, effected by the entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

Many FP entities have been subject to more stringent internal control and enterprise risk management guidelines than NP organizations, due to requirements from regulators such as the Securities and Exchange Commission (SEC), and the Federal Reserve Bank. Cross-sector collaborations will require NP management to focus more attention on implementing and maintaining sound internal control policies and procedures. The efficient use of ERM is also critical for successful cross-sector collaborations. In order to obtain a successful collaboration, nonprofit managers must understand and identify internal control measures and their relationship to ERM.

The recent economic turmoil has led to focused of attention on risk oversight in the corporate sector, but efforts towards robust enterprise risk monitoring are lagging or non-existent in public entities. It would be worthwhile for board members with governance responsibilities of NP entities engaging in cross-sector collaboration agreements to understand the relationship between corporate governance, internal controls, and ERM, and implement risk management practices.

Collaborations between nonprofit and FP organizations provide an opportunity to expand services provided by the nonprofit to its constituents. Numerous factors must be considered before entering cross-sector collaborations, yet the underlying charitable mission and goal of the NP must remain in the forefront. Cross-sector collaborations offer an opportunity to diversify services, and potentially increase efficiency. A NP that focuses on program awareness, while maintaining a customer-centered focus, will not only enhance its reputation among stakeholders, but will also increase visibility within the community and ultimately be able to better serve its current and future constituents.

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